In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 44

UNITED STATES OF AMERICA, PETITIONER

v.

AARON ZACKS AND FLORENCE ZACKS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

REPLY BRIEF FOR THE UNITED STATES

The contentions of the respondents are adequately dealt with in our principal brief. This reply brief is addressed solely to the issues raised by the New York, Chicago & St. Louis Railroad Company (the "Nickel Plate") in its brief *amicus curiae*.

In our main brief, we contended that a statute the terms of which are limited to prescribing a rule of substantive tax law cannot properly be read as prescribing also a new limitations period for the bringing of a suit for refund, a subject matter on which the statute is silent. Rather, we argued, the normal statute of limitations remains in force and the suit for refund is barred unless a claim was filed "within three years from the time the return was filed * * * or within two years from the time the

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tax was paid" (Section 322(b)(1), Internal Revenue Code of 1939). Nickel Plate argues, however, that in the case of a statute which retroactively creates new substantive rights, the date of the adoption of the statute should, for purposes of Section 322(b)(1), be deemed the date of a constructive "payment" of the taxes previously paid (Br. 19-21). Analytically, the argument necessarily turns upon an interpretation, not of the retroactive substantive statute, but of the statute prescribing the limitations period, Section 322(b)(1). In effect, the argument interprets "the time the tax was paid" as meaning, not the time of the remittance, but the time at which a payment of tax becomes, by virtue of a change in the law, an *overpayment*. Under that interpretation, every statute which retroactively creates new rights but is silent as to limitations would automatically operate—by satisfying a condition upon which the application of Section 332(b)(1), as so interpreted, depends—to start the limitations period running anew. Thus, despite Nickel Plate's initial suggestion (Br. 3, 17) that the effect of each retroactive statute should depend upon a search of the legislative materials for a specific indication of Congressional intent—an "intent" on a subject matter with which the statute in no way deals—it in fact contends for a rule of no less universal application than the government's.

In support of the surprising content it would pour into the word "paid," Nickel Plate contends that such an interpretation is necessary to avoid defeating the purpose of retroactive statutes. And as a particular-

ized example of the frustration of Congressional purpose that would otherwise occur, it calls the Court's attention to Section 94 of the Technical Amendments Act of 1958, 72 Stat. 1606. Normally we would not reply at length to a collateral question presented by an *amicus curiae*, but in this instance it seems appropriate to do so. The reason is that Section 94 of the Technical Amendments Act of 1958 is a statute which demonstrates in a uniquely striking way the point we seek to make: that there are many reasons, not always apparent, why Congress might wish to prescribe a new substantive rule applicable to generally barred years without the consequence of reopening the statute of limitations, and that a rule that such a statute reopens the limitations period even when it in no way so provides by its terms would produce wholly unwanted consequences. What is unique about Section 94 is that the reasons for its enactment are documented not only by the usual Congressional materials but also by findings by a Commissioner of the Court of Claims (whose report in Nickel Plate's pending case is appended to this brief) of the extra-Congressional developments leading to its enactment. What those materials show beyond a doubt is that Section 94 was neither more nor less than an *ad hoc* legislative ratification of a settlement agreement designed to avoid litigation—an agreement which had been worked out by representatives of the government and the railroads over a two-year period and which was necessarily applicable only to those railroads which had kept their taxable years open.

1. The circumstances giving rise to the enactment of Section 94, as found by the Commissioner in Nickel Plate's pending Court of Claims action (pp. 14–27, *infra*), may be briefly summarized as follows:

In 1942 and 1943, the Interstate Commerce Commission ordered all Class I railroads to change from the "retirement" to the straight-line depreciation method of accounting for certain roadway assets. Most of the railroads sought permission from the Commissioner of Internal Revenue to change their accounting methods for tax purposes to conform to the new ICC requirement. The Commissioner granted his consent, but only on condition that each railroad agree to set up a reserve (in the amount of 30 percent of the original cost of the roadway properties) reflecting the Commissioner's estimate of the depreciation already accrued as of the date of the change-over in accounting method. Many railroads, including Nickel Plate, signed so-called "terms letters" agreeing to establish such reserves (Fdg. 3). These "terms letters" provided, *inter alia*, that the sum remaining to be recovered through depreciation allowances should be limited to the cost or other basis minus the prescribed reserve, and that accumulated earnings and profits should be reduced by the amount of the reserve (*i.e.*, the amount of depreciation chargeable to prior years) in determining the taxpayer's invested capital for excess profits tax purposes (Fdg. 3). The effect of the latter requirement was to reduce Nickel Plate's excess profits credits for 1943 and 1944 and hence to increase its excess profits taxes for those years.

Several of the railroads (not including Nickel Plate) contended that the conditions imposed by the terms letters were illegal, a position which found support in several court decisions. Throughout 1954 and most of 1955, government officials negotiated with representatives of the railroads in an effort to settle the dispute and thereby avoid extended litigation. It was assumed that the terms of an agreement arrived at by top level officials could be applied on a company-by-company basis through the use of formal closing agreements (Fdg. 6). Preliminary conferences produced a favorable reaction, both from the Commissioner and from the General Counsel of the Treasury (Fdg. 7).

On November 3, 1955, Joseph M. Jones, then counsel for Nickel Plate, wrote Leonard Spaulding (a representative of the Service) that only two of his firm's railroad clients—Nickel Plate not among them—had pending claims involving the excess profits tax issue and therefore would be affected by this phase of the settlement (Fdg. 11). The letter assumed, quite accurately, that the Commissioner would be precluded by existing law from making a refund in the absence of a timely claim.

Two weeks later, at the government's request, a survey was taken of all Class I Line Haul Railways (including Nickel Plate) to ascertain the cost of settling the World War II excess profits tax issue on various alternative bases. This survey, like the Jones letter, was predicated on the assumption that the settlement would be applicable only to railroads with timely

claims pending. Of the 126 railways questioned, 12 reported that they had timely claims pending; 59 that their World War II excess profits tax years were closed or not subject to possible refund claims; 25 that they had paid no excess profits taxes during the war years; and 11 that the excess profits tax controversy did not, for various other reasons, involve them (Fdg. 11). The replies of the 12 railroads who stood to benefit from a compromise of the excess profits tax issue showed that the net tax loss to the government would be $10,500,000 or $13,901,651 or $17,300,000, depending on whether the 30% reserve requirement was reduced to 15%, to 10%, or to 5%. Nickel Plate, of course, was not one of the 12 railroads expected to qualify for a refund.

The above information was given to representatives of the government in late November, 1955, and another conference held on December 5. There Fred Scribner, General Counsel of the Treasury Department, outlined what he regarded as a fair solution to the controversy. He insisted, however, over the protests of the railroad spokesmen, that the arrangement must be approved by Congress, in view of the large amounts involved and the possible political ramifications if the action were taken administratively (Fdg. 12). Accordingly, in June 1956, a bill was introduced in Congress embodying essentially the same excess profits tax provisions that were enacted two years later as Section 94(f)(1) of the Technical Amendments Act of 1958 (Fdg. 13). Those provisions adhered closely to the terms of the proposed administrative settlement

and called for a reduction of accumulated earnings and profits as of the change-over date, not by the 30% reserve required by the "terms letters," but by the amount of depreciation sustained before March 1913 (Fdg. 12; § 94(f)(1)).

2. The hearings and debates on Section 94 make it clear that the sole purpose and effect of that provision was to place the congressional seal of approval upon the settlement agreement described above. In introducing the House proposal (Section 81 of H.R. 8381) which was ultimately enacted as Section 94 of the Technical Amendments Act of 1958, Congressman Wilbur Mills, Chairman of the House Ways and Means Committee, stated (104 Cong. Rec. 1222):

> Mr. MILLS. Mr. Chairman, let me take just a moment to advise the membership of the Committee that this amendment is interpreted by the membership of the Committee on Ways and Means as legislating into law a settlement. Frankly, that is what I interpret it to be.
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> * * * * *
>
> Since that time [1942] a number of court decisions have dealt with the tax effects of the retirement method of computing depreciation and with the tax effects in changing from this method. These decisions relate to a number of different issues. They involve widely varying factual situations and relate, of course, to a very complicated subject. In general, they have thrown doubt upon the validity of the 30-per cent reserve requirement imposed upon the railroads under the terms letters. As a

result of these decisions, the railroads and the Internal Revenue Service have been engaged in a continuing controversy over the tax effects of this change in method of computing depreciation. The proposed amendment is, in essence, a settlement of this controversy. We are, in effect, legislating into law this settlement.

If the Internal Revenue Service failed completely to sustain its position in court, it has been estimated that there might be a revenue loss of as much as $273 million—in refunds and interest—for the years 1943–55, and that, for the period 1956–95, there would be a total reduction in income taxes approximately $50 million greater than under the proposed amendment. If the amendment is adopted, the Government will pick up approximately $250 million which it would have lost if it failed to sustain its position in court, and, in addition, will pick up an additional $50 million by limiting the deductions for the years 1956–95.

Similarly, during the Senate Finance Committee hearings on the bill, after passage by the House, Senator Paul Douglas expressed concern as to the amount of the revenue loss entailed by the proposed amendment compared with the loss which would result if the controversy went to litigation. Thus, in a colloquy with a representative of the American Association of Railroads (Hearings before the Senate Finance Committee, *infra*, pp. 382–385, fully set forth in the footnote below),[1] Senator Douglas stated his under-

[1] *Senator Douglas.* Mr. Hellenbrand, did you represent the Association of American Railroads in the negotiation of the agreement which resulted in section 81?

standing that "an out-of-court settlement has been made between the Treasury and the railroads which the Congress is now asked to legitimatize by enacting into law"; he inquired as to "the estimated total amount that either was in litigation or would be in litigation if section 81 were not passed," and suggested that attorneys for the government be asked "to come down here

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Mr. Hellenbrand. I participated as a representative of the committee.

Senator Douglas. Was there any evidence on this submitted to the House Ways and Means Committee?

Mr. Hellenbrand. A subcommittee of the House Ways and Means Committee held a hearing for, I believe, a full morning, at which I testified.

Senator Douglas. Was it included in the original bill submitted by the House Ways and Means Committee to the floor?

Mr. Hellenbrand. It was not.

Senator Douglas. It was added as a floor amendment, by Congressman Mills.

Mr. Hellenbrand. Yes, sir.

Senator Douglas. Does this represent an agreement between the Treasury and the Association of American Railroads?

Mr. Hellenbrand. Well, it represents the result of the efforts of the representatives of the Treasury Department and the committee representing the association.

Senator Douglas. How many cases are in litigation now, Mr. Hellenbrand, on this point?

Mr. Hellenbrand. I know of two at least. And the Treasury Department, as I understand it, and the Department of Justice, have deferred moving the trials on these cases pending resolution of this question by legislation, so that the cases have not progressed further for that reason.

Senator Douglas. How much do you think is involved?

Mr. Hellenbrand. Senator Douglas, I think in the statement before you I have a table in the back, on page 11, which shows the effect of the situation as it now is, and as it would be under the court decisions as we interpret them.

And you will notice, sir, that the effect of the bill is to deny refunds entirely for the prior years. And the further effect

and give an account of this, and find out how much we got, how much the taxpayers got, how much the railways got, and what the prospects would have been of recovery if suit had been carried on, and so forth." (Hearings before the United States Senate Committee on Finance on H.R. 8381, 85th Cong., 2d Sess., pp. 383, 385.)

Again, in testimony before the Senate Finance Committee (Senate Hearings, *supra*, p. 387), Dr. Paul Zeis, Financial Vice President of the Akron, Canton & Youngstown Railroad, stated:

> Section 81 deals with the so-called terms letter railroads. This section is presented as an

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of the bill is to reduce the amount of allowable deductions which would be available to us under the statute, as compared to what they would be if the court decisions were applied.

I might add——

Senator Douglas. I do not think your answer was very responsive to my question. What I am trying to get as is, What is the estimated total amount that either was in litigation or would be in litigation if section 81 were not passed?

* * * * * * *

Senator Douglas. Let's see if I understand the situation. In effect an out-of-court settlement has been made between the Treasury and the railroads which the Congress is now asked to legitimatize by enacting into law?

Mr. Hellenbrand. I think that is substantially what the chairman of the Ways and Means Committee said when he presented the bill in the House.

I should add, however, Senator, that this agreement, as it has been characterized here, we are fully satisfied is entirely consistent and applying the principles that have been laid down by the courts in this very complex system of group accounting and the refund problem that is involved.

As a matter of fact, the railroads have given up, in one area particularly, an item to the Treasury amounting to $100 million of deductions in this process which we think is perhaps beyond

agreed measure between the major railroads and the Treasury Department. We have no objection to section 81 as such. We should like to point out, however, that section 81 simply involves legislative confirmation or approval of an administrative settlement that has been worked out between the major railroads and the Treasury Department. In other words, what is being asked is congressional sanction for an administrative compromise or modification of the terms letter agreements which could be affected without legislation by closing agreement or otherwise.

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that which the courts have done, and we feel quite sure of that.

But in order to expedite the disposition of this problem, which is already old, we have been willing to do this.

Senator Kerr. Will the Senator yield?

Senator Douglas. Yes.

Senator Kerr. Is it correct to say, not that the Treasury and the railroads have made an agreement as to what the law ought to be, but that they have arrived at the conclusion jointly that this would be the method of complying with the law as declared by the courts?

Mr. Hellenbrand. Yes, sir.

Senator Douglas. I think this issue should be raised before the committee, Mr. Chairman, rather than addressed to the witness. I think there is a very real question here whether this is a settlement that should be put into statute law or a settlement which could be arrived at between the attorneys for the Government and the railways directly without constitutional sanction.

And if it is desired to put it into law, then I think we ought to ask the attorneys for the Internal Revenue—who are the Government attorneys in this case.

Mr. Hellenbrand. The Treasury Department and the Internal Revenue Service.

Senator Douglas. I think we ought to ask the attorneys for the Government to come down here and give an account of this, and find out how much we got, how much the taxpayers got, how much the railways got, and what the prospects would have been of recovery if suit had been carried on, and so forth.

3. The import of this legislative history is clear. If the out-of-court settlement had been put into effect without submission to Congress, only those railroads in a position to litigate the excess profits tax issue—*i.e.*, only those which had filed timely refund claims—would have benefited from its terms. It was not the purpose of Section 94 to broaden the application of the compromise agreement, or to confer upon any railroad benefits which it plainly could not have obtained through litigation. On the contrary, the impetus for the legislation came, not from the railroads, but solely from the Treasury, which was unwilling to accept responsibility for a compromise of such magnitude. The question Congress was asked to decide—and the one to which Congress addressed itself—was whether the proposed arrangement was a favorable settlement from the government's standpoint, *i.e.*, whether it would cost the Treasury less than the railroads might reasonably expect to win by going to court. Plainly, therefore, the congressional intent would be completely defeated if Section 94 were given the effect of authorizing refunds of excess profits taxes paid 15 or 16 years earlier by 59 railroads, only a handful of which had claims not already barred by the statute of limitations.

It is worth pointing out, finally, that the Technical Amendments Act of 1958 contained 103 sections, eight of which (§§ 14, 29, 36, 63, 92, 93, 96, and 100) expressly extended for grace periods of sixty days (§ 96), six months (§§ 14, 36, and 92), one year (§§ 29, 93, and 100), or a period measured either by the date of pub-

lication of regulations or revocation of an election permitted by the section (§ 63), the time for filing refund claims otherwise barred. Two of these were the sections immediately preceding Section 94, and three of these (§§ 29, 36, 63), like Section 94, permitted taxpayers to elect whether their substantive provisions were to apply. The only possible inference is that when Congress intended to reopen closed years, it did so explicitly.

Respectfully submitted.

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OCTOBER 1963.

APPENDIX

In the United States Court of Claims

No. 385–61

(Filed July 23, 1962)

THE NEW YORK, CHICAGO AND ST. LOUIS RAILROAD COMPANY

v.

THE UNITED STATES

REPORT OF COMMISSIONER

To the honorable the CHIEF JUDGE AND ASSOCIATE JUDGES OF THE UNITED STATES COURT OF CLAIMS:

Pursuant to the order of reference in the above-entitled case, the undersigned Commissioner makes the following report of his findings of fact:

1. Plaintiff is a domestic railroad corporation, subject to the jurisdiction of the Interstate Commerce Commission, with principal offices in Cleveland, Ohio. At all pertinent times plaintiff has followed the accrual method of accounting and is the owner of the claims here sued upon.

2. Plaintiff timely filed its excess profits tax returns on the accrual basis for the calendar years 1943 and 1944 with the Collector of Internal Revenue at Cleveland Ohio, and paid excess profits taxes, not refunded or credited, in excess of the refunds here claimed.

3. (a) The Acting Commissioner of Internal Revenue sent a "terms" letter to plaintiff under date of September 15, 1944, which reads as follows:

> Reference is made to your letter dated March 20, 1943, in which you apply for permission to change from retirement to depreciation accounting with respect to road property.
>
> Permission will be granted to change from retirement to depreciation accounting effective January 1, 1943, with respect to the accounts tabulated below, provided you irrevocably agree:
>
> (1) that a reserve for depreciation shall be computed as of December 31, 1942, on all depreciable property included in these accounts in accordance with the summary tabulation set forth below;
>
> (2) that the remaining sum to be recovered through depreciation allowances shall be limited to the cost or other basis less the depreciation so accrued;
>
> (3) that neither the change of method nor the amount of depreciation so accrued shall have any effect on taxable net income for any year ending prior to January 1, 1943;
>
> (4) that the depreciation rates agreed to are subject to modification if subsequent experience indicates that revision is necessary in order to spread the cost of the assets over their remaining useful lives, such revision however, is not to be made retroactive;
>
> (5) that complete depreciation accounting in accordance with all the applicable sections of the Internal Revenue Code and Regulations shall be adopted for these accounts;
>
> (6) that the reserve for depreciation accrued to the date of the change from retirement to depreciation accounting shall reduce accumulated earnings and profits in the determination

of invested capital for excess profits tax purposes.

Account No.	Classification	Cost at Dec. 31, 1942	Rate[1] (Percent)	Accrued depreciation at Dec. 31, 1942
2½	Other right-of-way expenditures	[illegible]	1.[illegible]	[illegible], 071.48
3	Grading	2,7[illegible]	1.[illegible]	625,[illegible]
6	Bridges, trestles, and culverts	12,124,7[illegible]	1.[illegible]	2,[illegible].75
13	Fences, snowsheds, and signs	[illegible]	2.00	442,197.[illegible]
16	Station and office buildings	[illegible]	[illegible].19	1,[illegible],015.45
17	Roadway buildings	2[illegible],752.[illegible]	2.10	[illegible]
18	Water stations	1,1[illegible]	2.[illegible]	370,709.11
19	Fuel stations	[illegible]	2.17	1[illegible]
20	Shops and enginehouses	3,071,[illegible]	[illegible]	1,0[illegible]
26	Telegraph and telephone lines	[illegible]	2.[illegible]	10[illegible],911.87
27	Signals and interlockers	3,343,175.00	2.10	1,1[illegible]
29	Power plants	27,345.00	1.[illegible]	7,[illegible].91
31	Power-transmission systems	167,[illegible]	2.[illegible]	41,910.[illegible]
35	Miscellaneous structures	[illegible],310.00	2.[illegible]	[illegible].54
37	Roadway machines	31[illegible]	[illegible].25	127,[illegible]
39	Public improvements—construction	[illegible],[illegible],10[illegible]	1.49	[illegible]
44	Shop machinery	1,[illegible]	2.[illegible]	[illegible]
45	Power-plant machinery	1[illegible]	2.[illegible]	74,[illegible].73
765	Miscellaneous physical property	1,[illegible],579.[illegible]	1.[illegible]	[illegible],573.70

[1] Applicable to gross cost.

It is mutually understood that this is an agreement in principle and that a detailed investigation of the depreciation basis has not been made by the Bureau, and that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should investigation disclose errors of cost or valuation. In the event of any such correction, the accrued depreciation at December 31, 1942, shall be appropriately adjusted, but no retroactive adjustment shall be made to depreciation which may have been allowed subsequent to December 31, 1942.

It is further mutually agreed that the road assets listed below, which have been retired in 1943, or are to be retired in 1944, have not been included in the basis for depreciation, and that retirement losses are to be allowed on the abandonment of these assets. In the determination of these losses, however, the

amounts stated shall be reduced by the depreciation sustained prior to March 1, 1913.

MAJOR ASSETS RETIRED OR TO BE RETIRED IN YEAR DESIGNATED AND EXCLUDED FROM THE DEPRECIATION BASIS

Account No.	Classification	Year 1943	Year 1944
6	Bridges, trestles, and culverts	$91,628.00	$10,907.00
16	Station and office buildings	7,972.00	14,782.00
18	Water stations	915.00	37,573.00
20	Shops and enginehouses	28,224.00	25,700.00
27	Signals and interlockers	94,793.00	258,993.00
44	Shop machinery		47,073.00

Permission to change from retirement to depreciation accounting as of January 1, 1943, will become effective upon receipt of a letter agreeing to all the terms and conditions set forth herein, signed with the corporate name and pen signature of the president, vice-president, or other principal officer, over his official title. It is requested that your acceptance letter be submitted in duplicate.

(b) In reply to the above letter, plaintiff sent a letter to the Acting Commissioner of Internal Revenue under date of September 23, 1944, which reads, in pertinent part, as follows:

The New York, Chicago and St. Louis Railroad Company agrees to all the terms and conditions set forth in your said letter of September 15, 1944, with the understanding that in the event the terms and conditions under which railroads are granted permission to change from retirement to depreciation accounting as set forth in said letter shall be modified or changed by law, regulation, ruling, or otherwise, the fact that The New York, Chicago and St. Louis Railroad Company has agreed to said terms and conditions shall not preclude it from receiving the benefit of any such modifications or changes in these terms and conditions which are applicable to railroads in general, and The

New York, Chicago and St. Louis Railroad Company shall be entitled to the benefit of any such modifications or changes, regardless of this agreement.

(c) Plaintiff's accumulated earnings and profits were developed and its excess profit tax rates for the years here pertinent were filed, in accordance with the then existing ruling of the Internal Revenue Service as set forth in said terms letter. (See finding 3(a), *supra*.)

4. In Section 94 of Public Law 85-866, the so-called Technical Amendments Act of 1958, which was enacted on September 2, 1958, the Congress provided for an election by certain taxpayers to reduce the above specified 30 percent reserve for past depreciation in a manner prescribed therein. Section 94(f)(1) of this Act provided affected taxpayers with the basis for recomputation of excess profits taxes previously paid, by authorizing the recomputation of accumulated earnings and profits in the manner therein prescribed in determining the equity invested capital under Section 718 of the 1939 Code, as of the changeover date and as of the beginning of each taxable year thereafter. Under date of October 13, 1959, the final regulations under Section 94 of the Act were promulgated. On or about November 19, 1959, plaintiff filed an election, claiming the benefits of Section 94.

5. On or about August 1, 1960, and within two years of the enactment of the aforesaid legislation, but after the expiration of the period specified in Section 322(b)(1) of the Internal Revenue Code of 1939 or Section 6511 of the Internal Revenue Code of 1954, plaintiff filed formal claims for refund of the aforesaid taxes, which claims were based upon facts and grounds substantially in accord with those herein

sued upon. No other claims have been filed covering the relief sought. Formal action disallowing the said claims was taken by the Commissioner's delegate under date of September 8, 1961. This suit was filed within two years of said disallowance.

6. Throughout the year 1954 and most of the year 1955, a special committee comprised of a small group of railroad tax lawyers, (hereinafter referred to as the "Committee"), worked with various Government representatives in an effort to secure an overall compromise at the administrative level of certain tax problems created by the action of the Commissioner of Internal Revenue in imposing the 30 percent reserve for past accrued depreciation, as a condition for permission to change from the retirement to the straight line method of depreciation accounting. It was assumed by the Committee that if a pattern could be agreed upon and approved by responsible top-level Government officials, these tax problems could be eliminated and extended litigation avoided by applying the pattern, company by company, evidencing the agreed adjustments by formal closing agreements.

7. Following preliminary conferences which produced a favorable reaction, particularly from Mr. T. Coleman Andrews, then Commissioner of Internal Revenue, and Mr. Albert P. Tuttle, General Counsel of the Treasury Department, a letter was forwarded to the Commissioner by the Committee under date of September 3, 1954, calling attention to the opinion of the Tax Court in the *Akron, Canton & Youngston Railroad Company* case, decided June 25, 1954, 22 T.C. 648, and urging recognition at the administrative level of the illegality of the conditions imposed on the railroads at the time of the changeover. Follow-up conferences were held late in 1954 and early in 1955; but

due, in part, to various changes in top-level personnel in the Treasury Department and Internal Revenue Service, no substantial progress was made. However, during this period the requirement that at least a reserve for pre-1913 depreciation be substituted for the 30 percent reserve crystalized in the minds of Government representatives.

8. Under date of July 18, 1955, Mr. Frank Barnett, Vice President and Eastern General Counsel of the Union Pacific Railroad Company, on behalf of the Committee, wrote a letter to Mr. Laurens Williams, who had recently been named Assistant to the Secretary of the Treasury for income-tax matters, urging "administrative solution to the illegal reduction of the cost basis of railroad ways and structures by an arbitrary amount of 30%", which could be "performed through administrative clarification". On July 27, 1955, Mr. Williams reported that he had reviewed the 30 percent problem with Mr. David Kendall, then General Counsel of the Treasury Department, and with Mr. John P. Barnes, then Chief Counsel for the Internal Revenue Service, and that Mr. Kendall wished to participate in negotiations for an industry-wide settlement.

9. Mr. Barnett again wrote Mr. Williams on September 12, 1955, referred to various circumstances which had delayed the anticipated top-level conference, stated he sincerely felt "that this is a matter which can and should be handled administratively" and urged a conference as soon as Mr. Fred Scribner (who was then succeeding Mr. Kendall as General Counsel of the Treasury Department) would be available. Such a conference was held in Mr. Scribner's office on October 12, 1955. Messrs. Williams, Barnes, and Leonard A. Spaulding, employed in the Interpre-

tive Unit of the Internal Revenue Service, also represented the Government at that conference. Mr. Barnett, as spokesman for the Committee, called Mr. Scribner's attention to the fact that litigation was mounting and urged that the matter be disposed of administratively on an industry-wide basis. During the course of the conference, Mr. Spaulding suggested that a reserve for pre-1913 depreciation should, in any event, be substituted, if the 30 percent reserve was to be eliminated. Mr. Scribner concluded that this phase should be further developed and other details explored before attempting to reach an agreement for disposing of the problem.

10. In line with Mr. Scribner's suggestion, the Committee met with Mr. Spaulding and Ralph Staebner, and other representatives of the Engineering and Valuation Branch of the Internal Revenue Service, on November 1, 1955, for the purpose of exploring the details involved in developing a reserve based upon pre-1913 depreciation. The Government representatives expressed the view that adjustments of depreciation should be made prospective only and it was proposed that January 1, 1955, should be made the effective date, if any compromise agreement were approved. At this conference, Mr. Spaulding indicated he could see that there was a stronger argument for elimination of the Clause (6) condition of the terms letter, relating to the adjustment of earnings and profits for excess profits tax purposes, and he would be receptive to a proposal to allow retroactive relief to that extent. He requested an estimate as to the amount involved in this respect.

11. On the basis of the assumption that the Commissioner of Internal Revenue would be precluded by existing law from making any refund in the absence of a timely claim, Mr. Joseph M. Jones, counsel for

plaintiff, wrote Mr. Spaulding, under date of November 3, 1955, and advised that of the railroad clients of his firm (including plaintiff herein) only the Burlington, Wabash, and Bangor and Aroostook had pending claims involving the excess profits tax phase of the settlement being negotiated and would therefore be affected by this phase of the settlement. Similarly, at Mr. Barnett's request, Mr. A. R. Seder, a vice president of the Association of American Railroads, by circular dated November 18, 1955, advised the Chief Accounting Officers of all member roads of the pending efforts to reach an administrative compromise on the 30 percent problems and requested estimates of refunds, based on varying degrees illegality of 30 percent reserve for "World War II excess profits tax years still open or subject to possible refund claim." This circular stated as follows:

> At the request of a subcommittee of the General Tax Committee having to do with the 30% reserve matter, I today sent to you the following telegram:
>
> "In connection with the discussions of possible basis of compromise on question of 30 percent reserve for past accrued depreciation required by terms letter authorizing change-over from retirement accounting to depreciation accounting for depreciable roadway property, Government representatives have asked for estimate of effect reduction in reserve under Condition 6 of the terms letter would have on excess profits tax liability. To enable us to furnish this information will you please advise (1) what World War II excess profits tax years are still open or subject to possible refund claims and (2) total of estimated net decrease in tax for each open year (giving effect to income tax adjustments) resulting from increase in equity invested capital excess profits tax credit for World War II tax years which would

be caused by a reduction of reserve of 30 percent of depreciable assets to (a) 5 percent, (b) 10 percent, (c) 15 percent. Do not recompute depreciable allowances in developing the foregoing. Will greatly appreciate receiving this information by Friday, November 25, by wire if necessary, for use in further meeting with Treasury officials on Monday, November 28."

You will note that the presently requested estimate relates only to the net decrease in tax which would result from the increase of equity invested capital for World War II tax years if a reduction of the reserve required upon changing from retirement accounting to depreciation accounting were reduced from 30% to (a) 5%, (b) 10% and (c) 15%. Thus, it is not necessary to recompute the depreciation allowance in developing this estimate. Also, you will note that this information is desired by Friday, November 25th, for use at a meeting of the subcommittee with Treasury officials set for Monday, November 28th. In this connection I quote from the letter addressed to Mr. Thomas L. Preston, General Solicitor of this Association, by a member of the subcommittee requesting this information:

"I think it would be of very great benefit to the entire railroad industry if we could have this information available for the November 28th meeting and, therefore, have drafted the enclosed request in the form of a telegram which I request be sent out as soon as reasonably possible."

All of the responses to this circular were tabulated and summarized by Mr. R. L. Ettenger, Jr., Assistant Vice President of the Association of American Railroads, in a letter sent to Mr. Barnett under date of November 29, 1955, which stated, in pertinent part, as follows:

Pursuant to the request contained in your letter of November 17 to Mr. Preston, we asked

all Class I Line Haul Railways to furnish us with an estimate of the net tax decrease which will result from decreasing the 30% reserve set up for unrecorded depreciation when the change from retirement to depreciation accounting was authorized for tax purposes. A copy of our circular of November 18 (which repeats the telegram of the same date) is attached so that you may have before you the exact language upon which the estimates were based. There is also attached copy of an "Alphabetical List of Class I Steam Railways in the United States" which shows the names of the companies addressed.

A summary of the responses to the inquiry shows:

Number of Class I Railways addressed	126
Number of replies received	126
Of the 126 replies received—	
12 reported that an increase in equity capital would decrease their net tax liability	
59 reported no World War II excess profits tax years open or subject to possible refund claims	
25 reported no excess profits tax payments during World War II years	
19 reported that they did not change to depreciation accounting during World War II	
2 reported that they were on average earnings base	
6 reported that their accounts were included in other replies	
3 replies were not classifiable, but no reduction in tax was indicated[1]	
126	

The replies of the 12 railways reporting estimated reductions in their net tax are further refined hereunder:

[1] Under correspondence.

Reduction in reserve from 30% to 10%

Road	1942	1943	1944	1945	Total
AT & SF		$1,0[illegible]	$119,[illegible]	$1,2[illegible]	$3,[illegible],100
ACL	(¹)	36,945	474,127	2[illegible],912	6[illegible]
Bangor & A			30,274	32,3[illegible]	64,[illegible]
C & O			827,[illegible]		827,[illegible]
CB & Q		6[illegible]	70[illegible]	70[illegible]	2,042,[illegible]
NYC	[illegible]	3[illegible]	174,[illegible]		610,[illegible]
SP		1,0[illegible]	2,334,[illegible]	1,107,[illegible]	4,5[illegible]
AGS	34,449	34,44[illegible]	68,7[illegible]	31,[illegible]	104,4[illegible]
GS & F	21,[illegible]	21,[illegible]	46,[illegible]	24,[illegible]	115,[illegible]
T & P		¹ 1[illegible]	¹ 20,8[illegible]	15,471	1[illegible]
UP		¹ [illegible]	74,[illegible]	7[illegible],100	1,2[illegible]
Wabash			3[illegible]	170,[illegible]	3[illegible]
Total	182,[illegible]	4,0[illegible]	4,[illegible],667	4,[illegible]	12,001,661

¹ Inclusive.

This letter also contained comparable figures for the 12 railroads listed above, based on the assumptions that the reserve was reduced from 30 percent to 5 percent and from 30 percent to 15 percent. The total reductions in net tax based on the latter two assumptions were, respectively, about $17,300,000 and $10,500,000. No other such industry surveys were made. Plaintiff is a Class I Line Haul Railway.

12. The above information was made available to Government representatives, and another conference between members of the railroad Committee and representatives of the Treasury Department and Internal Revenue Service was scheduled and held in Mr. Scribner's office on December 5, 1955. Messrs. Williams, Barnes, and Spaulding (identified in findings 8 and 9, *supra*), were present at and participated in, this conference. After a general review of the situation, Mr. Scribner indicated that he thought a fair solution would be to substitute for the 30 percent reserve the appropriate pre-1913 depreciation reserve, with prospective application for all phases, except that retroactive effect would be proper for the purpose of computing earnings and profits under Clause (6) of the terms letter. Following the conference and on

the same day, Mr. Joseph M. Jones, who, as a member of the railroad Committee, attended the conference, dictated a memorandum covering the meeting in which he stated, in part, as follows:

> The new angle which Mr. Scribner then introduced was his conclusion that this should be reflected in legislation. It had been assumed from the previous discussions that this compromise would be made effective through the administrative processes of having each company compute its substitute reserve and consummate the change with a statutory closing agreement.

The railroad representatives who attended the conference protested by pointing out the delay and uncertainties that would necessarily be involved in pursuing the matter through legislative rather than administrative channels. Mr. Scribner replied in substance and effect that, while he was fully aware of the problem and was generally sympathetic, he felt he must pass the responsibility on to Congress in view of the large amounts involved and the possible political ramifications if such action were taken administratively. It was suggested that both sides get together to discuss the form which the legislation should take.

13. Under date of June 25, 1956, H.R. 11917 was introduced in the House of Representatives embodying essentially the same provisions with respect to the excess profits tax feature here involved as were eventually enacted in Section 94 of the Technical Amendments Act of 1958.

14. The parties are in agreement that the sole matter in dispute between them involves a legal issue as to whether the claims for refund (see finding 5, *supra*) were timely filed. The parties further agree that if the court holds that timely claims for refund

were filed, plaintiff is entitled to compute its accumulated earnings and profits for the years here involved (1943–1944, including the effect thereon of any carrybacks properly allowable from 1945 and 1946 of unused excess profits credits) in the manner specified in said Section 94(f)(1) of said Technical Amendments Act (see finding 4, *supra*), thus increasing its excess profits credits for the pertinent years and entitling it to a refund of excess profits tax paid for the said years, together with interest as provided by law, the amount of which is to be determined under Rule 38(c).

Respectfully submitted,

FRANKLIN M. STONE,
Commissioner.

U.S. GOVERNMENT PRINTING OFFICE: 1943